Credit Cards vs. Debit Cards

Credit and debit cards look alike and they are used in virtually identical ways. But there are some significant differences that make them both important tools to have in your financial toolbox.

Credit Cards

By definition, spending with a credit card means you are spending money you don't have – it's a loan. Many people use credit cards and pay off their balances each month in full, incurring no fees or interest. Others carry balances from month to month, meaning they are paying interest on money they have already spent, and could be charged a fee for missing a payment. These "revolvers," as they are called in the credit card industry, are a gold mine for credit card companies, earning them billions of dollars per year in interest and fees.

So unless you don't have enough money in your checking account to make a purchase, why would you ever need to use a credit card? Fraud protection is one important reason. Credit cards provide automatic, predictable fraud protection that limits your liability in case your card is stolen or used without your permission. Thanks to the Fair Credit Billing Act, you have little or no liability for unauthorized charges, damaged goods, or for merchandise that was never delivered.

Credit card issuers also provide dispute settlement when you ordered something that wasn't what was promised or if a merchant refuses to refund your money. These protections are especially important for mail order transactions or in cases of identity theft.

Debit Cards

Spending with a debit card means you're spending *your* money – it comes directly from your checking account. When the money is gone, it's gone. When used properly, spending with debit cards can be part of a solid strategy for spending within a budget and staying out of unplanned debt.

Compared with the fraud protections of credit cards, your liability when using debit cards depends greatly on the policies of your financial institution. In the worst case scenario, meaning you don't discover fraudulent charges for more than 60 days, you could be responsible for all charges. If you report fraudulent charges before the 60 day limit, you could be responsible for up to $500. Be sure to get full details from your financial institution, and keep in mind that these policies can vary over time. Further, many institutions offer generous protection policies, but limit it to the geographical area they serve – meaning an out of state charge may not be covered at all.

Debit Cards and "Courtesy Overdraft Protection"

Courtesy overdraft protection is a fee-based service most financial institutions offer to help consumers avoid declined debit card charges. If you overdraw your account, the charge will not be declined - the bank will loan you enough money to cover the transaction for a fee, typically around $35. No matter how small the overdraft, the same fee applies. If you do not have a credit card, courtesy overdraft protection *might* be useful in an emergency, but it is an extremely expensive loan in the vast majority of cases. You may also be charged multiple fees before you realize your account is overdrawn.

If you are charged a courtesy overdraft fee and you are not interested in the service, you can cancel it at anytime. Setting up a true line of credit or linking your savings and checking accounts are much more cost effective ways of dealing with occasional overdrafts.

A good strategy is to use a credit card for internet and mail order purchases – just make sure to pay off your credit card balance to avoid interest charges.

College Foundation of North Carolina

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